[JOINT COMMITTEE PRINT]

SUMMARY OF REVENUE MEASURES IN THE ADMINISTRATION'S BUDGET FOR FISCAL YEAR 1983

PREPARED FOR THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

AND THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, D.C. 20515

ERRATA SHEET FOR JCS-3-82 (March 2, 1982)

("Summary of Revenue Measures in the Administration's Budget for Fiscal Year 1983")

On page 13, second and third paragraphs (relating to the effective date for the Administration's energy tax incentive proposal):

Change February 8 to February 26.

As a result of an additional refinement by the Treasury Department, on page 28, second paragraph (relating to the foreign tax credit for the Administration's corporate minimum tax), delete the last sentence and replace it with the following:

"Foreign taxes in excess of the current year's limitation could not be carried over to be used against the minimum tax in other years."

INTRODUCTION

This pamphlet is a summary of the revenue proposals in the Administration's fiscal year 1983 budget. In most cases, the Treasury has provided a technical explanation of the proposals, and this summary is based on that explanation. In some cases, however, the summary is based on the general explanation provided in the budget documents.

The first section of the pamphlet is an overview of the Administration proposals. The second section is a detailed summary of both the relevant present law and the Administration proposals. The third section is a table showing the Administration's estimates of the budget effects of its proposals.

I. OVERVIEW

Income tax provisions

(1) ***Completed contract method.***—The Administration proposes to amend the regulations regarding accounting for long-term contracts to limit the current deduction of costs in cases where the recognition of income associated with those costs is deferred. It also proposes legislation to repeal the completed contract method of accounting for long-term contracts and to require that taxpayers use either the percentage of completion or progress payment methods of accounting for such contracts.

(2) ***Business energy tax incentives.***—The Administration proposes to repeal those business energy tax incentives which are currently scheduled to extend beyond 1982.

(3) ***Industrial revenue bonds.***—The Administration proposes to deny accelerated cost recovery deductions to property financed by tax-exempt industrial revenue bonds, limit the use of small issue industrial revenue bonds to small businesses, and place certain other restrictions on the use of tax-exempt bonds for private purposes.

(4) ***Construction period interest and taxes.***—The Administration proposes to require that corporations amortize over 10 years interest and taxes paid or accrued during the construction period of a non-residential building.

(5) ***Modified coinsurance.***—The Administration proposes to eliminate the use of modified coinsurance arrangements by life insurance companies to recharacterize investment income as underwriting income.

(6) ***Minimum tax.***—The Administration proposes to replace the present add-on minimum tax for corporations with an alternative minimum tax equal to 15 percent of an expanded income base which would be paid if it exceeds regular tax liability.

(7) ***Enterprise zones.***—The Administration plans to submit legislation providing tax incentives for investments made in enterprise zones.

Tax collection and enforcement

(1) ***Withholding on interest and dividends.***—The Administration proposes 5-percent withholding on interest and dividends.

(2) ***Cash management.***—The Administration proposes several ways of accelerating collection of corporate income taxes through speeding up both estimated tax payments and payment of tax liability when tax returns are filed.

(3) ***IRS staff increases.***—The Administration proposes to increase the number of IRS employees by 5,225.

(4) ***Debt collection.***—The Administration proposes a series of administrative and legislative changes to improve collection of debts owed to the U.S. government.

Excise taxes

(1) ***Airport and airway taxes.***—The Administration proposes to reinstitute the Airport and Airway Trust Fund and to increase or impose several aviation excise taxes to finance the trust fund.

(2) ***Highway Trust Fund.***—The Administration intends to propose legislation extending the Highway Trust Fund, and related taxes, past the current expiration date of September 30, 1984.

(3) ***Federalism Trust Fund.***—The Administration intends to propose legislation putting several federal excise taxes in a Federalism Trust Fund which, along with those taxes, would be phased out between 1988 and 1991. A number of federal spending programs would be phased out as well.

Employment taxes

(1) ***Hospital insurance tax.***—The Administration proposes to extend the federal payroll tax for hospital insurance (Medicare) to federal employees.

(2) ***Railroad retirement system.***—The Administration proposes to integrate the railroad retirement system into social security and federal unemployment insurance.

User charges

The Administration proposes to institute or increase a variety of user charges, including the following:

(1) Coast Guard user fees;
(2) Navigation user fees;
(3) Nuclear waste disposal fees;
(4) Energy regulatory fees;
(5) Recreation fees;
(6) Patent and trademark fees;
(7) Passport and visa fees; and
(8) Certain other fees

Revenue effects

The Administration's proposals would have a net budget effect of $2.5 billion in fiscal year 1982, $15.9 billion in 1983, $23.3 billion in 1984, and $28.1 billion in 1985. These numbers include the revenue effects of both the proposed legislation and administrative changes, as well as the effects on budget outlays of those user charges which are accounted for in the budget as "offsetting receipts."

II. SUMMARY OF ADMINISTRATION PROPOSALS

A. Income Tax Proposals

1. Completed Contract Method of Accounting

Present Law

Overview

Under present law, taxpayers may elect to use one of three accounting methods to account for income and deductions attributable to long-term contracts. (Long-term contracts generally are contracts that are not completed in the taxable year in which they are entered into.) Two of these methods, the completed contract method and the percentage of completion method, are commonly referred to as "long-term contract methods" and apply only to long-term contracts. The third method is the accrual method of accounting.

Long-term contract methods

Completed contract method

Under the completed contract method, income from long-term contracts is not recognized until the taxable year in which the contract is completed. A taxpayer may use this method even though payments are received and products are delivered and placed in service before completion of the contract.

Percentage of completion method

Under the percentage of completion method, the portion of income realized from a contract which corresponds to the percentage of the entire contract which has been completed during the year is included in gross income for that taxable year.

Contract costs and period costs

Under both the completed contract method and the percentage of completion method of accounting for long-term contracts, all of the contractor's costs must be allocated to the contract (called "contract costs") or allocated to the taxable year when paid or incurred (called "period costs"). Under the completed contract method, all contract costs are deducted in the year the contract is completed. Under the percentage of completion method, contract costs are deducted in the year paid or incurred.

Period costs are deductible in the year paid or incurred regardless of when income is recognized under the completed contract method or the percentage of completion method.

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Under present Treasury regulations, costs that must be allocated to the contract include:

1. Direct material and labor costs.
2. Certain enumerated indirect costs, e.g., indirect labor, utilities, rental payments for equipment or facilities, and depreciation of capital equipment to the extent of depreciation taken into account for financial reporting purposes.

Indirect costs that may be deducted currently include:

1. Marketing and selling expenses, including bidding expenses;
2. Advertising expenses;
3. Other distribution expenses;
4. Interest;
5. General administrative expenses;
6. Research and development;
7. Certain losses;
8. Pension and profit-sharing contributions;
9. The excess of cost recovery allowances over book depreciation on capital assets;
10. The excess of percentage depletion over cost depletion;
11. Depreciation and amortization on idle equipment and facilities;
12. Income taxes attributable to long-term contracts;
13. Costs attributable to strikes, rework labor, scrap and spoilage; and
14. Compensation paid to officers attributable to long-term contractor's activities as a whole.

Accrual method

Under the accrual method of accounting, income and expenses (including the cost of inventory sold) can be recognized when the inventory is shipped or is accepted by the purchaser. Thus, in the case of a long-term contract involving a single item, the accrual method of accounting results in income recognition very similar to the completed contract method.

As in the case of the long-term contract methods of accounting, all of the contractor's costs must be allocated either to his inventory (called "inventoriable costs") or to the year in which paid or incurred (called "period costs"). Under the present Treasury regulations (commonly referred to as the "full absorption" regulations), direct production costs must be allocated to inventory and indirect production costs are allocated between inventory costs and period costs under two rules. The first rule applies to taxpayers whose method of accounting for production costs is comparable for tax and financial reporting purposes. In such a case, the regulations provide that certain specified indirect production costs must be inventoried, that certain specified items are treated as period costs, and that other costs are inventoried for tax purposes where they are inventoried for financial reporting purposes. The second rule applies to taxpayers who do not use comparable accounting methods for tax and financial reporting purposes. In such a case, the regulations provide essentially the same allocation of costs provided for under the long-term contract methods of accounting.

Administration Proposal

Overview

The Administration has proposed changes to both the Treasury regulations and the provisions of the Internal Revenue Code that relate to accounting for long-term contracts. The legislative changes would, if enacted, render moot some of the regulatory changes.

Regulatory proposal

Treatment of indirect costs

Under current regulations, certain indirect costs incurred by a taxpayer in the performance of particular long-term contracts must be allocated to such contracts. However, other costs (such as general and administrative expenses, interest, research and experimental expenses, accelerated depreciation, pension costs and other employee benefits) are treated as costs which are not required to be allocated to long-term contracts, even if such costs are incurred in the performance of particular long-term contracts.

The regulations would be amended to require that all indirect costs that directly benefit the performance of long-term contracts and an appropriate part of all other indirect costs must be allocated to long-term contracts. The only exceptions to this general rule would be the following expenses:

(a) General marketing, selling and advertising expenses;

(b) Bidding expenses incurred in the solicitation of contracts not awarded to the taxpayer;

(c) Research and experimental expenses neither directly attributable to particular long-term contracts in existence at the time such expenses are incurred nor incurred under any agreement to perform such research or experimentation;

(d) Losses under section 165 and the regulations thereunder;

(e) Depreciation and amortization on idle equipment and facilities;

(f) Income taxes attributable to income received from long-term contracts;

(g) Pension contributions to the extent that they represent past service costs; and

(h) Costs attributable to strikes.

Thus, indirect costs such as the cost of successfully bidding on a contract and pension and benefit costs for current employee services would be allocated to the long-term contract.

Treatment of indirect production costs of inventory

Under existing regulations, taxpayers are not required to use a long-term contract method to account for contracts meeting the definition of a long-term contract. Taxpayers engaging in long-term contracts may use the accrual method of accounting with inventories, assuming the goods they manufacture constitute inventory. The proposal would amend the regulations to provide that taxpayers who use the accrual method and inventories to account for long-term contracts must allocate indirect production costs to the cost of inventory in the same manner that indirect costs would be

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allocated to long-term contracts under the proposal. Thus, whether a taxpayer used a long-term contract accounting method or the accrual method with inventories, the same indirect costs generally would be allocated to the contract or the goods produced under the contract, and the same indirect costs would be deductible as period costs.

Severing and aggregating long-term contracts

The regulations relating to long-term contracts would also be amended to clarify whether an agreement or series of agreements is considered one contract or more than one contract. Under present Treasury regulations, a series of agreements generally is not aggregated into a single contract unless customary commercial practice treats the agreements as a single contract or unless there is no business reason for entering into several agreements rather than a single agreement.

Under the proposal, the regulations would be amended to provide that two or more agreements will not be considered as a single contract if the agreements were priced independently. In addition, increases in the number of goods to be supplied under an agreement would be treated as one or more additional contracts.

Other regulatory changes

Under the proposal, the regulations relating to the accrual method of accounting for long-term contracts would also be amended to require the accrual of income and expenses upon the shipment or acceptance of each unit of a multi-unit contract. Thus, in the case of a multi-unit contract, a taxpayer using the accrual method would be unable to achieve the same result as under the completed contract method.

The regulations relating to long-term contract accounting would be modified to provide rules relating to when a contract is "completed." The proposed amendments will provide that a contract will be considered complete without regard to any term of the contract providing for additional compensation contingent upon the continued successful performance of the subject matter of the contract after the subject matter of the contract has been initially accepted by the purchaser (for example, an incentive bonus payable if a satellite remains in operation for twenty months after it is placed in orbit). Further, a contract will be considered complete without regard to any obligation on the part of the contractor to provide replacement parts or to supervise installation or assembly of the subject matter of the contract.

Legislative proposal

A new section would be added to the Internal Revenue Code to provide rules for accountng for long-term contracts, as defined in regulations to be prescribed by the Secretary. The new section would provide that all long-term contracts must be accounted for under either the percentage of completion method or a new method called the "progress payment method." Taxpayers would not be allowed to use the completed contract method or the accrual method to account for long-term contracts.

Under the progress payment method, the taxpayer would include in income all "payments" when the taxpayer has a right to the payment under the contract. The term "payment" would include certain borrowed amounts, such as loans from the purchaser and loans secured by the contractor's rights under the contract. Costs allocable to the contract would be deducted only when, and to the extent, the taxpayer includes payments in income. In effect, income will be recognized for a taxable year for a particular contract when cumulative payments under that contract for that taxable year and all prior years exceed all costs allocable to that contract for that year and all prior years to the extent that such excess payments have not been included in income for any prior taxable year. Losses would be recognized only when costs allocable to the contract for that year and all prior years exceed the total amount the taxpayer has a right to receive under the contract.

A special rule would be provided for advance payments received or accrued before work on a contract has commenced. Under this rule, advance payments would be included in income ratably over a 12-month period beginning with the month the payment is received or accrued. For advance payments that are a significant percentage of the total amount to be received under the contract, taxpayers would be permitted to request a longer period over which the payment would be included in income.

Costs allocable to the contract under either the percentage of completion method or the progress payment method would include all costs other than the following costs:

(a) General marketing, selling and advertising expenses;

(b) Bidding expenses incurred in the solicitation of contracts not awarded to the taxpayer;

(c) Research and experimental expenses neither directly attributable to particular long-term contracts in existence at the time such expenses are incurred not research or experimentation;

(d) Losses under section 165 and the regulations thereunder;

(e) Depreciation and amortization on idle equipment and facilities;

(f) Income taxes attributable to income received from long-term contracts;

(g) Pension contributions to the extent that they represent past service costs; and

(h) Costs attributable to strikes.

This allocation of costs would be the same as the allocation proposed under the Administration's regulatory proposal.

The determination of whether a taxpayer must recognize income for a particular year is made on a contract by contract basis. Thus, taxpayers may not offset income from one contract with costs of another contract. If for example, a taxpayer has two contracts, Contract A and Contract B, and progress payments exceed costs with respect to Contract A but not with respect to Contract B, the taxpayer will recognize income from Contract A, even if the excess costs from Contract B equal or exceed the income recognized from Contract A.

Effective date

The regulatory and legislative proposals would be effective for taxable years beginning after December 31, 1982.

Taxpayers required to change their method of accounting pursuant to the regulatory proposal are permitted to elect one of three transitional rules. Under the first rule, a taxpayer would be required to take any income adjustment resulting from the change into account in the year of change. However, such a taxpayer would be able to treat the change as one not initiated by the taxpayer and, thus, the adjustment would not include any amount attributable to a period before January 1, 1954. Under the second rule, a taxpayer would be permitted to spread any adjustment necessitated by the change over the lesser of 10 years or the number of years the taxpayer has been on its current method. However, to the extent a portion of the adjustment is attributable to a contract which is completed during a taxable year, such portion must be taken into account in that taxable year. The third rule provides that taxpayers may elect to use the cut-off method to account for the required change. Under this third approach, the new regulatory rules would apply only to contracts entered into after February 26, 1982.

Taxpayers required to change their method of accounting pursuant to the legislative proposal would use the cut-off method to account for the required change, but the new rules would apply only to contracts entered into after February 26, 1982. Under the cut-off method, payments and costs incurred in taxable years beginning after December 31, 1982, would be accounted for under the new method.

2. Business Energy Tax Incentives

Present Law

Overview

Under present law, investment tax credits and other tax incentives are provided to encourage businesses to purchase property used to conserve oil and gas or to produce alternative sources of energy. In addition, tax incentives are available to encourage production and use of fuels produced from coal, oil shale, wood, biomass, and alcohol.

Energy investment credit

In addition to the regular investment tax credit and cost recovery allowances, present law provides a nonrefundable energy tax credit for investments in certain business energy property. In general, the credit is 10 percent, although some types of energy property qualify for up to a 15-percent energy credit. Most of the business energy credits expire on December 31, 1982.

To be eligible for an energy credit, property must be depreciable with a useful life of three years or more. In addition, property must be new property. The energy credit (but not the regular credit) is available for structural components of a building that otherwise qualify as energy property.

Property eligible for a 10-percent energy credit includes alternative energy property (primarily equipment that uses a substance other than oil or natural gas as a fuel or feedstock), cogeneration equipment, recycling equipment, shale oil equipment, equipment for producing natural gas from geopressured brine, biomass property, and intercity buses. Specially defined energy property also qualifies for a 10-percent energy tax credit. Items specified as specially defined energy property include recuperators, heat wheels, heat exchangers, and automatic energy control systems. To be eligible, the principal purpose of the equipment must be to reduce the amount of energy consumed in an existing commercial or industrial process. In addition to the specified items, the Secretary may add additional items of qualifying property if certain standards are satisfied. That authority has not yet been exercised.

Low-head hydroelectric property qualifies for an 11-percent energy credit. A 15-percent energy credit applies to solar or wind energy property, ocean thermal equipment, and geothermal equipment.

Although most of the business energy investment credits expire on December 31, 1982, the credits for solar or wind equipment, geothermal equipment, ocean thermal equipment, biomass equipment, and intercity buses expire on December 31, 1985. The credit for low-head hydroelectric property expires in 1988. In addition, special

rules allow businesses to claim credits on alternative energy property through 1990 for expenditures on projects for which an affirmative commitment has been made in a timely fashion.

Property used to provide electrical, gas, steam and other public utility services generally is not eligible for the energy credit.

Under double-dipping rules, the energy credit is reduced for property financed in whole or in part by subsidized energy financing or the tax-exempt proceeds of an industrial development bond.

The energy credit applies against all tax liability not offset by other tax credits. Excess energy credits from a taxable year may be applied, like regular investment credits, against tax liability for the 3 preceding and 15 succeeding taxable years.

Other energy tax incentives

Other energy tax incentives for business are tax-exempt financing, fuel production credits, and the excise tax exemption for alcohol fuels.

Industrial revenue bonds.—Tax-exempt financing is available for certain low-head hydroelectric facilities, solid waste disposal facilities, and certain property used to produce energy from renewable energy sources.

Production credit.—A credit of $3 for each barrel of oil equivalent, in BTUs, is available for fuel produced from a nonconventional source. Qualified fuels include oil produced from shale or tar sands; natural gas produced from geopressured brine, Devonian shale, coal seams, a tight formation or biomass; synthetic fuel produced from coal; qualifying processed wood fuel; and steam produced from agricultural waste. Except for processed wood and steam, these credits become available when the price of a barrel of oil falls below $29.50 (in 1979 dollars). In 1980, no credit was available. It is estimated that the credit will be approximately $1.50 a barrel in 1982 and $2.50 a barrel in 1983. A special (but similar) rule applies to natural gas. These credits apply to fuel produced before the year 2001 from facilities put in service or wells drilled before 1990.

Gasohol provisions.—Finally, present law provides an exemption from the 4-cents-per-gallon Federal excise tax on gasoline, diesel fuel, and other motor fuels for gasohol which is at least 10 percent alcohol. This amounts to a subsidy of 40 cents per gallon ($16.80 per barrel) for alcohol producers. If the tax exemption for gasohol does not apply, a tax credit is allowed. The credit is 40 cents per gallon for alcohol of at least 190 proof, and 30 cents per gallon for alcohol between 150 and 190 proof. There is a tariff on alcohol imported for use as fuel, which is designed to offset part of the benefit importers would receive from the gasohol tax incentives.

Administration Proposal

The Administration proposal would repeal all of the business energy tax credits that are not already scheduled to expire on December 31, 1982. The proposal would repeal the special provisions enacted in 1980 that allow State and local governments to issue tax-exempt bonds to finance low-head hydroelectric facilities and facilities that produce steam or alcohol from solid waste, and for

certain State programs for energy conservation. The proposal would repeal the fuel production credit, the exemption of gasohol from the Federal excise tax on gasoline, and the alcohol fuel tax credit. In addition, the proposal would repeal the tariff imposed on imported alcohol fuel.

In general, the repeal of the business energy credits would be effective on January 1, 1983. However, taxpayers with binding contracts to acquire or construct energy property as of February 8, 1982, would continue to qualify for the present law energy credits for that property. For self-constructed property and for progress expenditure property (i.e., property with more than a 2-year construction period), the credits would apply for 1982 expenditures even though the property was not placed in service until after 1982. For property that qualifies under an affirmative commitment rule, like that in present law the credits would be extended through December 31, 1985.

The repeal of the other energy tax incentives also would be effective, in general, on January 1, 1983. However, alcohol fuel producers would be eligible for a production credit of 40 and 30 cents per gallon until December 31, 1985, for production from capacity either in place, or for which a binding purchase or construction contract has been signed, by February 8, 1982. After December 31, 1985, the credit for these facilities will phase out by 10 cents per gallon per year.

3. Limitations on Tax-Exempt Bonds for Private Activities

Present Law

Interest on State and local government obligations generally is exempt from Federal income tax. However, subject to certain exceptions, interest on State and local issues of industrial development bonds is taxable. An obligation constitutes an industrial development bond if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a governmental unit or tax-exempt organization [1] and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property or borrowed money used in a trade or business.

Present law provides an exception which exempts interest on industrial development bonds that are issued to finance certain exempt activities. In general, exempt activities for this purpose include: (1) certain projects for residential rental property, (2) sports facilities, (3) convention or trade show facilities, (4) airports, docks, wharves, mass commuting facilities, parking facilities, and directly related storage or training facilities, (5) sewage or solid waste disposal facilities and facilities for the local furnishing of electricity or gas, (6) air or water pollution control facilities, (7) certain facilities for the furnishing of water, (8) qualified hydroelectric generating facilities, and (9) qualified mass commuting vehicles. In addition, the interest on certain obligations issued for the purpose of acquiring or developing land as the site for an industrial park is exempt from taxation.

Present law also provides an exception for certain "small issues" to the general rule of taxability of interest paid on industrial development bonds. This exception applies to issues of $1 million or less if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property.

At the election of the issuer, the $1 million limitation may be increased to $10 million. If this election is made, the exception is restricted to projects where the aggregate amount of outstanding exempt small issues and capital expenditures (financed otherwise than out of the proceeds of an exempt small issue) made over a six-year period [2] does not exceed $10 million. Both the $1 million and $10 million limitations are determined by aggregating the face amount of all outstanding related issues, plus, in the case of the $10 million limitation, certain capital expenditures for all facilities

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[1] For example, interest on an obligation the proceeds of which are to be used in the trade or business which is not an unrelated trade or business, of a charitable organization, is exempt from tax.

[2] The relevant six-year period is the period beginning three years before the date of issue and ending three years after that date.

used by the same or related principal users which are located within the same county or same incorporated municipality.

Present law specifically excludes from gross income interest on qualified scholarship funding bonds. These generally are obligations of nonprofit corporations organized at the request of a State or political subdivision of a State for the sole purpose of acquiring student loan notes incurred under the Higher Education Act of 1965.

Interest on arbitrage bonds generally is not exempt from tax. In general, an arbitrage bond is an obligation which is issued as part of an issue all or a major portion of the proceeds of which can be reasonably expected to be used (directly or indirectly) (1) to acquire securities or obligations that may reasonably be expected, at the time of issue, to produce a materially higher yield than that on the bond issue, or (2) to replace funds that were used directly or indirectly to acquire such securities or obligations. However, present law generally exempts from this arbitrage limitation those bond proceeds which are invested at materially higher yields, during a temporary construction period or that become part of reserve funds.

For purposes of the arbitrage limitation, the term "yield" refers to that yield which, when used in computing the present worth of all payments of principal and interest to be paid on the obligation, produces an amount equal to the purchase price. Under Treasury Regulations, administrative costs may not be taken into account in determining either the yield or the purchase price (Treas. reg. sec. 1.103-13(d)). However, the portion of the regulations that defines "purchase price" to mean initial offering price to the public and the part which excludes administrative expense in computing purchase price were held invalid in a recent Tax Court case (*State of Washington* v. *Commissioner,* 77 T.C. No. 48 (1981)).

Administration Proposal

Overview

The Administration proposal would (1) provide new restrictions on the issuance of tax-exempt bonds for private purposes, (2) extend the arbitrage limitations to temporary construction period investments and reserve fund investments, (3) reduce the benefit from tax-exempt bonds by requiring an election between tax exempt financing and the accelerated cost recovery system, and (4) limit the use of small-issue bonds to small-businesses.

Additional restrictions on private purpose bonds

The Administration proposal would impose several new requirements on the issuance of tax-exempt bonds for private purposes. Private purpose tax-exempt bonds subject to these requirements would include industrial development bonds issued to finance exempt activities or industrial parks, small-issue industrial development bonds, qualified scholarship funding bonds, and bonds issued for use in a trade or business by charitable organizations. Mortgage subsidy bonds issued before January 1, 1984, would not be subject to these requirements.

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The following new requirements would be imposed with respect to the issuance of tax-exempt bonds for private purposes:

(1) Bond issues would have to be approved by the highest elected official or legislative body of the governmental unit by, or on whose behalf, the bonds are issued and in which the project financed by the bonds is to be located (or, in the case of qualified scholarship funding bonds, in which the eligible sellers of student loan notes are located). Alternatively, the public approval requirement could be met by a voter referendum. Prior to approval of a bond issue, a public hearing would be held. Furthermore, notice to the public would be required to be given prior to the hearing and promptly after approval of the bond issue.

(2) With respect to bonds issued after December 31, 1985, the governmental unit issuing the bonds would have to make a financial contribution or commitment to the project being financed with the bond proceeds. A contribution to the project would be required to have a present value equal to one percent of the face amount of the bond. The contribution could take the form of a cash payment, tax credit or abatement, provision of additional services, or payment of the bond issuance expenses. Alternatively, this requirement would be satisfied if the bonds were general obligation bonds of the State or local government, or if the State or local government assumed responsibility as the primary insurer or guarantor of the bonds.

(3) Bonds would be required to be in registered form and the issuance of obligations would be reported by the local government to the Internal Revenue Service.

Arbitrage limitations

The Administration proposal would eliminate the exception from classification as an arbitrage bond for reserve funds and funds held for a temporary construction period. Moreover, bond issuance costs would not be taken into account in determining the bond yield for purposes of the arbitrage limitation.

Election to use tax-exempt financing or ACRS

The costs of depreciable assets financed with any industrial development bonds could be recovered only under the straight-line depreciation method over the extended recovery periods used for earnings and profits computation purposes. The recovery periods would be as follows:

STRAIGHT-LINE RECOVERY PERIODS IF IDB-FINANCED

	Years
ACRS classifications:	
3-year property	5
5-year property	12
10-year property	25
15-year property	35
15-year public utility property	35

In the case of depreciable assets that are not completely financed with industrial development bonds, the slower depreciation would apply only to the portion financed with tax-exempt debt.

Restriction of small issue bonds to small businesses

The use of small-issue industrial development bonds would be restricted to small businesses. A small business would be a business with capital expenditures of less than $20 million during the period beginning three years before, and ending three years after, the issuance of the bonds.[3] Furthermore, bonds would not qualify under the small-issue exception if the business would have more than $10 million of industrial development bonds outstanding immediately after the sale of the bonds (excluding any previously issued bonds redeemed with the proceeds of the bonds in question). The $1 million and $10 million limitations of present law would continue to apply; however, bonds would not be disqualified solely because they are sold as part of a composite issue.[4]

Effective Dates

The proposals generally would apply to private purpose bonds, including refunding issues, issued after December 31, 1982. The provision requiring governmental units to make a financial contribution or commitment would apply to bonds issued after December 31, 1985. The proposals would not apply to mortgage subsidy bonds.

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[3] This $20 million limitation would operate in a manner somewhat similar to the $10 million limitation of present law. However, the $20 million limitation would apply to all capital expenditures regardless of where incurred, instead of capital expenditures within a single county or municipality under the $10 million limitation.

[4] Under Rev. Rul. 81-216, multiple lots of bonds at $1 million each are treated as a single large issue not qualifying under the small-issue exception if (1) the obligations will be sold at substantially the same time, (2) the obligations will be sold under a common plan of marketing, (3) the obligations will be sold at substantially the same rate of interest, and (4) a common or pooled security will be either used or available to pay debt service on the obligations. These requirements also are contained in proposed Treas. Reg. sec. 1.103-7, published in the Federal Register on Oct. 8, 1981.

4. Modified Coinsurance

Present Law

Overview

Although the income of a life insurance company is taxed at the usual corporate tax rates, its taxable income is computed under special provisions which may allow the company to reduce its tax liability if certain income items are characterized as underwriting income rather than investment income. Because of these provisions, life insurance companies have used certain kinds of reinsurance arrangements to recharacterize investment income as underwriting income.

A life insurance company has two primary sources of income—investment income, which is income from all assets, including income from any trade or business other than its insurance business, and underwriting income, which includes premiums and other income derived from the business of insurance. With respect to investment income, a life insurance company is taxed only on that portion of its investment yield (taxable investment income) not required to meet policy and other contract liabilities. Its overall gain (or loss) from operations is, generally, the sum of taxable investment income and underwriting income, less business expenses, policyholder dividends and certain other amounts. (By distributing policyholder dividends, a life insurance company shares favorable investment or underwriting experience with its policyholders. With limits, these dividends are deductible.) The special provisions for computing a life insurance company's taxable income require a comparison of its taxable investment income and its gain from operations. The result of the application of these provisions is that most life insurance companies can be classified as being in one of three tax phases.[1]

Phase I Company.—A Phase I company has a gain from operations that is less than its taxable investment income by $250,000 because it has reached the limit for deduction of policyholder dividends and certain other amounts. A life insurance company that would typically be in this phase is an established mutual company (owned by its policyholders), with substantial gains from its insurance business (i.e., underwriting gains). Such a company's gain from operations, before any policyholder dividend distributions,

[1] The tax phases result from the application of the statutory formula for computing taxable income (sec. 802(b)). The taxable income of a life insurance company is generally the sum of (1) the lesser of its taxable investment income or its gain from operations, and (2) one-half of any excess of gain from operations over taxable investment income. In a stock company, the other half of the excess of gain from operations over taxable income is credited to a policyholder surplus account and is subject to tax deferral until it is distributed to shareholders of the company. Thus, taxable income of a stock company could also include shareholder distributions of previously tax-deferred income though such distributions are unusual.

would exceed its taxable investment income. This company can use the deduction for policyholder dividends to reduce gain from operations, but not below an amount equal to taxable investment income, less $250,000. Thus, a Phase I company's taxable income is its taxable investment income, less $250,000.

Phase II (Positive) Company.—A Phase II (Positive) company has a gain from operations in excess of its taxable investment income. A typical life insurance company taxed under this phase would be an established stock company (owned by shareholders), which (unlike its mutual counterpart) has no state-law requirement to share favorable investment and underwriting experience with its policyholders. (A stock company will generally want to distribute excess funds to shareholders.) Under the Code, a Phase II (Positive) company's taxable income is generally the sum of its taxable investment income and one-half of the excess of its gain from operations over taxable investment income. Because a company's gain from operations is roughly the sum of its taxable investment income and its underwriting gain, a Phase II (Positive) company is taxed currently on one-half of its underwriting gain while the other half becomes part of a tax-deferred account (see footnote 1).

Phase II (Negative) Company.—A Phase II (Negative) company has a gain from operations that is less than its taxable investment income by more than $250,000 because of underwriting losses. Typically, a Phase II (Negative) company is a new or growing stock life insurance company that has underwriting losses from its insurance business because start-up costs associated with new insurance business are high in proportion to its total insurance business. In such a case, taxable investment income is reduced by the expenses of operating the company because the underwriting income alone is not sufficient to cover the costs of the insurance business. A Phase II (Negative) company's taxable income is its entire gain from operations.[2]

Coinsurance and modified coinsurance

Conventional coinsurance and modified coinsurance are two forms of indemnity reinsurance. Indemnity reinsurance is an arrangement between insurance companies in which Company A (the reinsured) transfers all or part of an insurance risk to Company B (the reinsurer), but remains solely liable to the policyholder. Under both forms of coinsurance, Company B usually assumes a share of the other contract liabilities (e.g., liabilities for cash surrender value and policyholder dividends) in proportion to the amount of insurance risk assumed. Thus, for tax purposes, Company B is generally treated as if it issued the original insurance policy to the extent of the risk it assumes under a coinsurance arrangement.

In exchange for its coinsurance assumption of the risk, Company B generally is entitled to a percentage of the premiums paid by the policyholders and of the investment income from assets associated with the reserve required for the assumed risk. Under conventional

[2] In addition to the three tax phases discussed above, there is also a "Corridor Phase" company, which is taxed on its entire gain from operations that is less than taxable investment income by an amount less than $250,000, and a "Phase III" company, which has taxable income that includes shareholder distributions of previously tax-deferred amounts from the policyholder surplus account (see footnote 1).

coinsurance arrangements, assets are actually transferred by Company A to Company B. Under modified coinsurance, the assets are treated on the records of each company as if transferred, but no actual transfer occurs. The amounts of premium and investment income credited to Company B under a modified coinsurance arrangement may or may not be proportional to the amount of risk transferred.

A conventional coinsurance or modified coinsurance arrangement generally requires that Company B pay Company A experience refunds. These refunds are similar to traditional policyholder dividends because they generally reflect both underwriting experience and investment experience associated with the insurance risks assumed by Company B. However, experience refunds are not subject to the limitation on the deduction for policyholder dividends. By treating these experience refunds solely as adjustments to underwriting income for both companies, life insurance companies have used coinsurance arrangements to recharacterize a portion of investment income as underwriting income.[3] Company A (either a Phase I or a Phase II (Positive) company) reports reduced taxable income because its taxable investment income is reduced when investment income is credited to Company B. When Company A receives an experience refund from Company B its underwriting income is increased. However, if Company A is a Phase I company, the increase in underwriting income is offset by an increased deduction claimed for policyholder dividends, and if Company A is a Phase II (Positive) company, only half of the increased underwriting income is taxed currently.[4] In either situation, Company A's reported taxable income is decreased. The decrease need not be matched by a corresponding increase in Company B's reported taxable income.[5]

Example.—Assume that Company A is a Phase I company that pays policyholder dividends. Although these dividends can offset all gain from operations in excess of taxable investment income, no more than $250,000 of the dividends can offset taxable investment income. However, Company A may be able to reduce its reported taxable investment income further under a coinsurance arrangement.

Under the coinsurance arrangement, Company A's reported taxable investment income is reduced because (along with premiums) investment income associated with the reinsured contracts is shifted from Company A (the reinsured) to Company B (the reinsurer). Company B reports both increased underwriting income and increased investment income to reflect assets transferred or amounts allocated to it under the arrangement. Each year Company B shares both favorable underwriting experience and favorable in-

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[3] The Internal Revenue Service suspended the issuance of ruling and determination letters relating to modified coinsurance arrangements on September 25, 1980, pending completion of a study (IRS News Release IR-80-98).

[4] Because taxation of one-half of the increased underwriting income is deferred for such a stock company, the overall effect for the current year is similar to taxing the increased underwriting income at one-half the regular corporate rate.

[5] Company B is often a Phase II (Negative) company which will have increased underwriting losses (attributuble to the experience refunds paid) to offset increased taxable investment income.

vestment experience on the reinsured contracts by paying Company A experience refunds.

When Company A receives experience refunds, its reported underwriting income is increased. Any increased underwriting gain is offset by an increased deduction claimed by Company A for policyholder dividends that would not otherwise be deductible because of the $250,000 limitation. The coinsurance arrangement has the effect of reducing Company A's reported taxable income.[6]

Administration Proposal

Under the Administration proposal, the provision of the Code that treats modified coinsurance arrangements as conventional coinsurance arrangements would be repealed. In addition, the proposal would clarify the treatment of experience refunds by providing for an allocation between investment and underwriting income. Also, the tax treatment of modified coinsurance arrangements would be revised to prevent disproportionate allocation of investment and underwriting income between the reinsured and the reinsurer.[7]

These provisions would generally apply to all reinsurance arrangements entered into after December 31, 1981. The provisions relating to experience refunds and disproportionate allocations would apply after December 31, 1981, to all modified coinsurance and other reinsurance arrangements.

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[6] If Company A is a Phase II (Positive) company, the transaction results in increasing the reported excess of its gain from operations over its taxable investment income but only one-half of that excess is includible in taxable income currently.

[7] The Administration also proposes to address the problem and change the treatment of experience refunds and of disproportionate allocation of income under modified coinsurance arrangements through amendments to the Treasury regulations.

5. Construction Period Interest and Taxes

Present Law

Under Section 189, individuals, personal holding companies, and subchapter S corporations are required to capitalize interest and real property taxes attributable to the construction period of real property to be used in a trade or business or held for investment. There is an exception to this rule for low-income housing. The capitalized interest and taxes are amortized (i.e., deducted in equal portions) over certain periods, generally 10 years. The interest that must be capitalized is interest which is attributable to the construction period on any debt incurred or continued for the purpose of acquiring, constructing, or carrying real property other than low income housing. The construction period is defined as the period beginning on the date construction of the building or improvement begins and ending on the date the property is ready to be placed in service or is ready to be held for sale.

The amortization of capitalized interest and taxes begins in the year the interest or taxes was paid or accrued. However, the amortization of capitalized interest and taxes is then suspended until the year the building or improvement is ready to be placed in service or to be sold, and amortization resumes at that time.

Corporations other than personal holding companies and subchapter S corporations are not subject to the capitalization requirement of section 189. For these corporations, amounts paid or accrued for interest and real property taxes are allowed as deductions for the year in which paid or accrued. Certain prepaid interest, however, must be capitalized and deducted in the years to which properly applicable. In addition, under section 266 of the Internal Revenue Code, taxpayers may capitalize certain taxes and interest attributable to both real and personal property and include the capitalized items in the basis of the property.

Administration Proposal

Section 189 would be amended to require corporations (other than personal holding companies and subchapter S corporations) to capitalize and amortize interest and taxes incurred in the construction of nonresidential real property. As under present law section 189, individuals, personal holding companies and subchapter S corporations would continue to be required to capitalize construction period interest and taxes for the construction of all real property other than low-income housing. As under present law, the amortization period will be ten years for taxpayers made subject to the provision. One-tenth of the capitalized interest and taxes will be deductible for the year in which they were paid or accrued. The other nine-tenths will be deductible over a nine-year period beginning

with the year in which the building is ready to be placed in service or is ready for sale.

The amendments to section 189 would apply to interest and taxes paid or accrued in taxable years beginning after December 31, 1982.

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6. Corporate Minimum Tax

Present Law

Under present law, corporations must pay a minimum tax on certain tax preferences. This tax is in addition to the corporation's regular tax. The amount of the minimum tax is 15 percent of the corporation's tax preferences in excess of the greater of the regular income tax paid or $10,000.

The tax preference items included in this base of the minimum tax for corporations are:

(1) Accelerated depreciation on real property in excess of straight-line depreciation over the useful life or recovery period (in the case of property eligible for ACRS, 15 years);

(2) Amortization of certified pollution control facilities (the excess of 60-month amortization over depreciation otherwise allowable);

(3) In the case of certain financial institutions, the excess of the bad debt deductions over the amount of that deduction computed on the basis of actual experience;

(4) Percentage depletion in excess of the adjusted basis of the property;

(5) 18/46 of the corporation's net capital gain;[1] and

(6) Amortization of child care facilities (the excess of 60-month amortization over depreciation otherwise allowable.).[2]

In computing the amount of the regular tax deductions from the corporation's minimum tax base, the corporation's regular tax liability is reduced by nonrefundable credits other than the credits relating to ESOPs. Credits (other than refundable credits) are not allowed against the corporate minimum tax.

In the case of individuals, a similar add-on minimum tax applies under present law except that the items of tax preferences also include (1) accelerated depreciation on personal property subject to a lease, and (2) intangible drilling costs on oil and gas wells in excess of the amount amortizable with respect to the cost, and in excess of net income from oil and gas production. Capital gains is not an item subject to the add-on tax for individuals. In the case of an individual, only one-half the regular taxes are allowed in computing deductions from the minimum tax base.

Individuals are also subject to an alternative minimum tax which is payable to the extent it exceeds the individual's regular tax paid.[3] The alternative minimum tax is generally based on the taxpayer's taxable income increased by (1) the deduction for long-

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[1] Special rules applicable to capital gains from timber have the effect of reducing the tax rate to 10 percent, increasing the exemption of $30,000, and allowing a regular tax carryover.

[2] The rapid amortization for child care facilities terminated for expenditures made after 1981.

[3] The comparison is made after the regular tax liability is reduced by all nonrefundable credits.

term capital gains and (2) the amount of the taxpayer's adjusted itemized deductions. The tax rate is 10 percent of the alternative minimum taxable income from $20,000 to $60,000 and 20 percent of the amount in excess of $60,000. Tax credits, other than the foreign tax credit, are generally allowable against this tax only if attributable to an active trade or business and only to the extent the tax is not attributable to net capital gains or to adjusted itemized deductions. Any credit disallowed by this rule increases the amount allowed as a credit carryover.

The foreign tax credit is allowed in full against the alternative minimum tax. In general, the regular foreign tax credit rules apply, but the foreign tax credit limitation is computed separately with respect to the alternative minimum tax. Thus, the amount of foreign tax that may be credited against the alternative tax is limited to the same proportion of the gross alternative tax as the taxpayer's alternative minimum taxable income from sources without the United States bears to his entire alternative minimum taxable income. The taxpayer is then required to pay an amount equal to the greater of the after-credit regular tax or the after-credit alternative minimum tax. A special rule is also provided for computing the amount of unused foreign taxes that may be carried back or carried forward.

Generally, an individual's preference for adjusted itemized deductions is the amount of a taxpayer's itemized deductions (other than the deductions for medical expenses, casualty losses, and state, local and foreign taxes) in excess of 60 percent of adjusted gross income (reduced by the itemized deductions excluded above). In the case of estates and trusts, certain additional adjustments are made.

No estimated tax payments of the minimum taxes are required.

Administration Proposal

Overview

The proposal would repeal the present law 15-percent add-on minimum tax for corporations and establish a 15-percent alternative minimum tax. Under the proposal, corporations would pay the alternative minimum tax only when it exceeds the regular income tax.[4] The proposal would not amend the present law minimum tax provisions for individuals.

The new alternative minimum tax would apply to domestic corporations (other than Subchapter S corporations and personal holding companies[5]) and foreign corporations engaged in a trade or business in the United States. In general, the tax base would be a corporation's regular taxable income, increased by certain tax preference items for the year. Net operating loss deductions would not be allowed in computing the minimum tax base. The tax base then would be reduced by a $50,000 exemption and taxed at a 15-percent rate.

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[4] See footnote 3.

[5] The preferences of Subchapter S corporations would continue to flow thru to their individual shareholders. Personal holding companies would continue to be subject to the add-on minimum tax.

The proposal would allow a foreign tax credit against the alternative minimum tax. No other credits would be allowed to offset the tax. The excess of the alternative minimum tax over the regular tax determined for any year would be carried over as a credit to be applied against the regular tax in future years.

Preferences

Existing tax preference items

Five preference items that would be added to taxable income in computing the alternative minimum tax base under the proposal would be identical to tax preferences subject to the present law corporate minimum tax. The capital gains preference under the present corporate minimum tax would not have to be added separately to the tax base since the alternative minimum tax base automatically would include it as part of regular taxable income. The five preference items from present law are as follows:

(1) ***Accelerated depreciation on real property.***—This item would include accelerated depreciation on low-income rental housing, 15-year recovery property (i.e., property eligible for the new recovery rules under ACRS), and other real property that is not recovery property. The amount of the preference would be the excess of depreciation allowable for the year over depreciation allowable using the straight-line method over 15 years.

(2) ***Amortization of certified pollution control facilities.***—This item would include amortization of certified pollution control facilities in excess of straight-line depreciation.

(3) ***Amortization of child care facilities.***—This item would include amortization of child care facilities in excess of straight-line depreciation.

(4) ***Reserves for bad debts of financial institutions.***—This item would include the excess of the bad debt deduction for certain financial institutions over the amount of that deduction computed on the basis of actual experience.

(5) ***Excess percentage depletion.***—This item would include percentage depletion in excess of the adjusted basis of the property at year end (without regard to any deduction for depletion for the year).

New tax preference items

In addition to existing minimum tax preferences, the following items would be included as tax preferences in the alternative minimum tax base:

(1) ***Intangible drilling costs.***—This item would include the deduction for intangible drilling and development costs of oil, gas, and geothermal wells (other than dry holes) in excess of the amount allowable had the costs been capitalized and amortized on the straight line basis over 10 years. There would be no offset for the net income from the properties for the year, as there is under the minimum tax for individuals.

(2) ***Mining exploration and development costs.***—This item would include deductions for mining exploration and development costs in excess of the amortization that would have been allowable on the straight line basis over 10 years.

(3) ***Lessors' safe harbor leasing benefits.***—The alternative minimum tax would include benefits attributable to safe harbor leases under the accelerated cost recovery system. The amount of the preference for each lessor (i.e., buyer of tax benefits) would be the excess of (1) the current year's ACRS deduction minus the excess of the rental income over the interest deductions with respect to the lease for the taxable year (i.e., the net deductions received by the lessor as a result of the safe-harbor sale-leaseback transaction) over (2) the initial amount of cash paid by the lessor to the lessee amortized over the lease term. Leases entered into before February 26, 1982, would be exempted.

(4) ***Deductions for debt to carry tax-exempt securities.***—This item would include interest on indebtedness to purchase or carry tax-exempt securities, to the extent this interest is deducted under current law. In determining the amount of the interest deduction to be added to the minimum tax base, the corporation's total interest deductions will be allocated pro rata across its total investment portfolio.

(5) ***Deferred DISC income.***—This item would include a corporate shareholder's pro rata share of DISC income for the year that is not taxed currently.

(6) ***Deferred shipping income.***—This item would include amounts deposited in construction reserve funds or capital construction funds under the Merchant Marine Act.

(7) ***Amortization of motor carrier operating rights.***—This item would include all deductions claimed under the five-year amortization provisions added by the Economic Recovery Tax Act of 1981 for motor carrier operating authorities which diminished in value as a result of the deregulation of motor carriers on July 1, 1980.

(8) ***Excess OID interest.***—This item would include interest deductible on original issue discount (OID) bonds in excess of the amount that would be deductible were the original issue discount amortized according to a method which yields the same pattern of deductions that would result from borrowing the same amount of money with par-value bonds having the same yield to maturity.[6]

(9) ***Deductions for costs incurred for long-term contracts.***—This item would include current deductions of certain indirect costs incurred for long-term contracts entered into on or before February 26, 1982. The amount of the preference would be the excess of those deductions over the deductions that would have been allowable if those costs were capitalized and deducted under the proposed progress payment method of accounting for long-term contracts. The indirect costs subject to this rule are those costs that would have to be allocated to long-term contracts subject to the proposed progress payment method of accounting were the contract entered into after February 26, 1982. (See section on "Completed Contract Method of Accounting" above.)

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[6] Under present law, when a taxpayer issues a bond for an amount less than the amount for which the bond will be redeemed at maturity, the difference (the original issue discount) may be deducted as interest ratably over the life of the bond. This linear amortization provides a more accelerated stream of interest deductions than would borrowing the same amount of money through par-value bonds with the same yield to maturity.

Net operating losses

Net operating loss (NOL) carryovers and carrybacks would not be allowable as offsets against the alternative minimum tax base. The amount of any NOL carryover or carryback allowable in computing the regular tax would be treated as absorbed, even for years the corporation pays the alternative minimum tax.

Foreign tax credit

Under the proposal, a taxpayer would be permitted a foreign tax credit against its alternative minimum tax. The credit would be computed in a manner similar to the way in which the present law foreign tax credit against the alternative minimum tax for individuals is computed. In general, the amount of foreign income taxes paid or accrued during the taxable year that could offset the minimum tax could not exceed the portion of the tax attributable to foreign source income. The present limitations for foreign oil income (sec. 907) would apply. Foreign taxes in excess of the current year's limitation could not be carried over to be used either against the minimum tax or the regular corporate tax in other years.

Other regular tax credits

No credits (other than the foreign tax credits) would be allowed as an offset against the alternative minimum tax. The amount of any unused credit carryover or carryback allowable in computing the regular tax would be treated as absorbed, even for years the corporation pays the alternative minimum tax.

Minimum tax credit

To prevent loss of tax benefits from credits or NOL carryovers, the proposal would establish a minimum tax credit. The minimum tax credit would be the excess of the alternative minimum tax liability for any year over the regular tax liability computed for that year. The credit would be applied as a carryover against the regular tax in subsequent years. The minimum tax credit would be applied after application of all other credits against the regular tax. The carryover period would be 15 years.

Estimated tax requirement

Estimated tax payments would be required to take into account any estimated alternative minimum tax liability.

Effective date

The new minimum tax provisions for corporations would apply for taxable years beginning after December 31, 1982.

7. Enterprise Zones

Present Law

Under present law, no general tax incentives are provided for the redevelopment of depressed areas. However, the section relating to mortgage subsidy bonds defines targeted areas for the purpose of promoting housing development within these areas. Within such areas, defined on the basis of the income of area residents or the general economic condition of the area, rules for the issuance of mortgage subsidy bonds are less restrictive than the generally applicable rules.

Administration Proposal

The Administration proposes that beginning January 1, 1984, up to 25 small urban areas per year (not to exceed 75 in total) may be designated as "enterprise zones." Special tax incentives and relief from regulation, designed to increase investment and employment, would be provided businesses and individuals locating in these areas. The Administration intends to present the details of is proposal at a later date.

B. Tax Collection and Enforcement Provisions

1. Withholding on Interest and Dividends

Present Law

Present law requires information reporting for payments of interest and dividends but does not require withholding on such payments except in the case of payments to certain foreign persons. A payor making a payment of interest or dividends subject to information reporting, or a corporation having outstanding registered evidences of indebtedness as to which original issue discount accrues during the calendar year, must generally file both a return with the Internal Revenue Service and a statement with the recipient. The dividend reporting requirements generally do not apply to distributions or payments made by or to foreign corporations, nonresident aliens, or partnerships not engaged in trade or business in the United States and composed in whole or in part of nonresident aliens. In general, interest paid by individuals (for example, interest paid by an individual on home mortgage payments), and amounts paid on obligations of a State, or local government, or U.S. possession, are not subject to the information reporting requirement. There is, currently, no reporting requirement with respect to interest payable on bearer obligations unless received and paid over by nominees. Likewise, payments of interest by foreign corporations, nonresident aliens, or partnerships composed of nonresident aliens (in whole or in part) are not subject to the information reporting requirements if they are not engaged in a trade or business in the United States.

The penalty for failure to file information returns or statements is $10 per failure unless such failure is due to reasonable cause. The maximum penalty for aggregate failures to file either returns or statements in any one calendar year is $25,000.

Administration Proposal

Overview

The Administration proposes withholding on dividend and interest payments at a flat 5-percent rate, beginning on January 1, 1983. Generally, the proposal would require withholding on payments by commercial and financial institutions and similar organizations to individuals, partnerships, and certain trusts in generally the same manner that tax is withheld on wages. Payments to corporations, including regulated investment companies (e.g., mutual funds), would not be subject to withholding; thus, intercorporate dividends and most commercial or financial transactions would be unaffected. Interest payments made by individuals, generally, would not be subject to withholding.

Withholding on dividends and interest

The Administration proposal would require reporting and withholding on dividend and interest payments aggregating $10 or more in any calendar year, subject to the discretion of the Secretary to require withholding on amounts less than $10. Under the proposal, withholding would be required on all payments and dividends to non-exempt persons for which information reporting to the Internal Revenue Service and the recipient is required under present law. In addition, the reporting and withholding requirements would be expanded to encompass, (1) any payments of taxable interest or accruals of original issue discount on all debt obligations of the sort generally offered to the public, and (2) any taxable dividend distribution by a corporation to a non-corporate recipient or any payment by a stockbroker to such a recipient as a substitute for a dividend. Dividend or interest payments to nominees and corporations, would not be subject to withholding. These entities would, however, be required to withhold from further dividend or interest payments made to non-exempt individual shareholders or principles. Obligations subject to the interest and original issues discount reporting and withholding requirements would include obligations of the United States, unregistered debt instruments issued by corporations, negotiable certificates of deposit, deposit accounts, and interest bearing checking accounts. Dividends subject to withholding would include all distributions out of current or accumulating earnings and profits, not including dividends reinvested in dividend reinvestment plans.

Recipients of taxable interest, original issue discount, or dividends would be required to attach the statements they will receive from the payors, showing the amount of the taxable item and the amount of tax withheld, to their income tax returns, just as is currently required for W-2's. Individuals making estimated tax payments could reduce their estimated tax payments by an amount equal to the withholding credit to which they would be entitled as of the payment date. Because of liberalizations on the wage withholding rules enacted in the Economic Recovery Tax Act of 1981, individual wage earners would be able to adjust their withholding allowances to reflect some or all of the amount of taxes which would be withheld from their dividend and interest income.

Time of withholding

Under the Administration proposal, withholding generally would occur when the taxable interest or dividend would be includible in the gross income of a cash basis taxpayer. In the case of cash payments, withholding would occur when the payment is made. In the case of constructive payments, such as may occur in the case of regulated investment companies, withholding would occur at the time of constructive receipt. Withholding on short-term corporate obligations would be required at interest payment dates, or if there were no stated interest, on maturity. If there were both interest payment and accrued original issue discount, withholding would need to cover both. Withholding on short-term discount obligations without stated interest, such as Treasury bills and bankers' acceptances would occur at maturity. Generally, interest on long-term

obligations including bearer obligations would be subject to withholding as interest payments are made, or if the obligation were a discount obligation with no stated interest, at least once annually. If there were no stated interest, of if stated interest payments were insufficient to allow withholding both with respect to stated interest and original issue discount, the withholding agent would need to charge principle for the required withholding. In the case of Series E and EE United States Savings Bonds, withholding would occur upon redemption.

Special rules would be provided for payments of interest on accounts with depository institutions. Ordinarily, withholding would occur when an amount is posted to the account; however, an option would be provided for depository institutions to withhold from passbook, interest bearing checking accounts and similar accounts on an annual basis. The withholding would be accelerated if an account were to be closed and the account could not be reduced below the accrued withholding obligation with respect to the account.

Exemptions from withholding

The Administration proposal would exempt from the withholding requirements payments made to two classes of recipients. First, taxable dividend and interest payments made to corporate recipients would not be subject to withholding. These corporate recipients would, however, withhold from any further distributions of dividends or interest to non-exempt persons. The corporate exemption would include interest paid to a corporate trustee. However, the corporation, as trustee, would be obligated to immediately withhold 5 percent of the trust's interest and dividends receipts. The credit arising from the withholding would be allocable between the trust and its beneficiaries according to the amounts of interest and dividend income giving rise to the credit allocable to each (or all to the grantor in the case of a grantor's trust).

Secondly, the proposal would exempt from withholding payments made to certain persons who file exemption certificates with the payor. Persons eligible to file exemption certificates would include (1) individuals who had no Federal income tax liability in the preceding taxable year and who reasonably expect to have no Federal income tax liability for the current taxable year, and (2) individuals 65 years of age or older who had tax liabilities of not more than $500 ($1,000 for married couples filing jointly) for both their prior and current taxable years (the Administration estimates that over 70 percent of all elderly persons would be exempt from withholding), (3) organizations, including State and local governments, exempt from income taxation (such as those described in sec. 501(a)), (4) noncorporate dealers in securities required to register as broker-dealers, and (5) noncorporate nominees. Individuals would not be allowed partial exemptions from withholding to reflect the $100 or $200 dividend exclusion or 15 percent net interest exclusion (effective after 1984) provisions. No withholding would be required on interest paid on All-Savers certificates or tax-exempt bonds.

Under the proposal an exemption certificate filed with the payor would remain in effect until revoked by the payee.

The administration proposal would not affect reporting or withholding requirements currently in place for interest and dividend payments to foreign individuals and corporations.

2. Accelerated Corporate Income Tax Payments

Present Law

Under present law, any corporation subject to tax is required to make payments of estimated tax if it reasonably expects to have an estimated tax liability for the taxable year of $40 or more. The estimated tax is payable in up to four installments over the taxable year. In general, if the estimated tax payments for the taxable year are not at least 80 percent of the actual tax due, then a penalty is imposed as an addition to tax. This penalty equals the amount of interest which would accrue on the amount of the entire underpayment of estimated tax during the period of the underpayment. Generally, this addition to tax does not apply with respect to any installment if, on or before the date prescribed for such installment, the corporation pays the amount which would have been due on that date if the estimated tax were the lesser of:

(1) The corporation's prior year tax liability;

(2) the corporation's tax liability on prior year's income computed using tax rates for the current year; or

(3) 80 percent of the taxes which would have been due if the income which the corporation had already received during the current year had been computed on an annualized basis.

In 1982 and 1983, large corporations (those with taxable income of $1,000,000 or more during any of the three previous taxable years) otherwise qualifying for treatment under either of the first two safe harbors will not be subject to the addition to tax if their estimated tax payments for the taxable year are at least 65 percent (in 1982) or 75 percent (in 1983) of the tax shown on their returns for that taxable year. In 1984 and thereafter the first two safe harbor rules are not available to large corporations. In 1984 and thereafter, therefore, a large corporation must either pay at least 80 percent of the amount of tax shown on its return for the taxable year, or 80 percent of the taxes which would have been due if the income which the corporation had already received during the current year had been computed on an annualized basis.

As a general rule, under present law, a corporation's income tax return is due 2½ months after the end of the corporation's taxable year. The tax required to be shown on the return is due at that time. However, if the taxpayer so elects, the tax may be paid in two equal installments. The first installment is due on the due date of the return. The second is due three months later.

Administration Proposal

The Administration proposal would result in the accelerated collection of corporate income taxes by (1) increasing the amount of estimated tax payments necessary to avoid the addition to tax for

underpayment of estimated tax from 80 percent to 90 percent of the tax shown on the return for the taxable year (with conforming changes being made to the third safe harbor provision), (2) requiring that all remaining tax owed be fully paid on the return due date, and (3) extending the phaseout of the availability of the first two safe harbor rules to large corporations (to reflect the increase in percentage of estimated taxes due to avoid penalty from 80 to 90 percent), by providing that only large corporations whose estimated tax payments are at least 80 percent for 1984 and 85 percent for 1985 of the amount shown as tax on their returns may avail themselves of the first two safe harbor rules.

3. Internal Revenue Service Staff Increases

Present Law

Public Law 97-92 (the third continuing resolution) enables the Internal Reveue Service to maintain an average of 85,363 positions during fiscal year 1982. Of this total number of positions, 14,556 are in the investigation and collection functions, 27,882 are in the examination functions, and 1,833 are in the appeals functions. The following table sets forth average employee levels in these three functions and in the entire IRS for fiscal year 1982 and the preceding three years:

	Number of positions			
	1979	1980	1981	1982
Function:				
Investigation and collection	11,753	12,802	13,185	14,556
Examination of deficient returns	27,747	28,370	27,402	27,882
Appeals	1,628	1,884	1,858	1,833
Total IRS employment	86,168	87,464	86,156	85,363

Administration Proposal

The Administration's budget request for fiscal year 1983 includes a net increase in Internal Revenue Service manpower of 3,310 average positions. Included in this request is a 5,225 increase in the number of employees committed to collection of delinquent taxes, determination of amounts of underreported income, and identification of improper deductions on tax returns. The additional employees to be distributed within the Internal Revenue Service in the following way:

Function:	New positions
Collection of delinquent accounts	3,000
Identification of nonfilers	1,000
Examination of deficient returns	1,000
Appeals	225
Total	5,225

4. Debt Collection Proposals

Present Law

Present law (the Internal Revenue Code and other Federal laws) contains several provisions governing the collection of debts owed to the Federal Government. These include the Privacy Act, the Federal Claims Collection Act of 1966, and Internal Revenue Code provisions relating to the disclosure of tax returns and return information and the interest rate on tax deficiencies.

The Privacy Act generally prevents a Federal agency from disclosing an individual's records without the individual's consent. Thus, delinquencies of debtors on their financial obligations to the Federal Government may not be referred to private debt collection agencies.

The Federal Claims Collection Act of 1966 deals in general with the collection of Federal debts. That Act, however, does not provide for the assessment of interest or penalties on debts owed to the Federal Government.

The Internal Revenue Code permits the Internal Revenue Service to disclose returns and return information to other governmental agencies, for the purpose of assisting them with debt collection, in several circumstances. For example, the IRS may disclose taxpayers' mailing addresses to officers and employees of Federal agencies, for their use in collecting Federal debts. However, this provision does not permit disclosure to agents of Federal agencies (*e.g.,* disclosure to private debt collection agencies). Moreover, there is no provision allowing the IRS to inform other Federal agencies whether applicants for Federal loans have any outstanding tax deficiencies.

Administration Proposal

The Administration has proposed a two-part debt collection effort, consisting of administrative and legislative initiatives.

The following administrative steps will be undertaken:

(1) Loan origination and servicing programs will be examined and made more effective; (2) agency collection officials will be better trained and held directly accountable for improved collection efforts; (3) the litigation process will be improved to allow for speedier and more effective action against debtors who have the ability to pay but refuse to do so; and (4) new tools and techniques will be utilized (for example, certain debt collection functions might be contracted out to the private sector).

In addition, the Administration has asked Congress for legislation, which contains both tax and non-tax provisions, designed to strengthen Federal debt collection. The tax-related provisions would: (1) require individuals who apply for Federal loans or assist-

ance to furnish their social security numbers; (2) permit the IRS to disclose to another Federal agency whether a Federal loan applicant has any outstanding tax liability; and (3) permit the IRS to disclose taxpayer mailing addresses to agents (*e.g.*, private debt collectors), as well as to officers and employees, of other Federal agencies for purposes of collecting Federal debts.

The major non-tax provisions of the proposal would: (1) allow Federal agencies to refer credit information on delinquent debtors to credit bureaus; (2) require the payment of interest on all debts owned to the Federal Government; and (3) provide specific authority for Federal agencies to contract with private collection agencies for purposes of debt collection (other than collection of tax debts).

Effective Date

The legislative proposals would be effective upon enactment.

C. Excise Taxes

1. Airport and Airway Trust Fund Taxes

Present Law

Trust fund receipts

During the period July 1, 1970, through September 30, 1980, the Airport and Airway Trust Fund was financed by the receipts from several earmarked excise taxes. These taxes are listed in the table below in the column "prior law." The largest source of revenues was the 8-percent tax on air passenger tickets. The fuels tax was the major source of funds derived from general aviation.

Since October 1, 1980, when authorization for the trust fund expired, the tax on air passenger tickets decreased to the pre-trust fund rate of 5 percent, and the receipts have been deposited into the general fund of the Treasury. Receipts from the 4-cents-per-gallon tax on gasoline used in general aviation are deposited in the Highway Trust Fund, as are the receipts from taxes on tires and inner tubes used for aircraft.

The table which follows shows the excise taxes and tax rates that were in effect and deposited in the trust fund before October 1, 1980, and the tax rates currently in effect for the same excise taxes.

SCHEDULE OF AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES UNDER PRIOR AND PRESENT LAW

Tax (and code section)	Prior law rate (July 1, 1970–Sept. 30, 1980)	Present law rate
Air passenger ticket (sec. 4261 (a), (b) and (d))[1]	8 percent	5 percent.
Air freight waybill tax (sec. 4271)	5 percent	0.
International departure tax (sec. 4261(c))	$3 per person	0.
Fuels tax for noncommercial (general) aviation (sec. 4041 (c))[2]	7 cents per gallon	4 cents per gallon on gasoline.[3]
Aircraft use tax (sec. 4491)[2]	(4)	0.
Aircraft tires tax (sec. 4071)	5 cents per pound	4.875 cents per pound.[5]
Aircraft tubes tax (sec. 4071)	10 cents per pound	10 cents per pound.

[1] Air transportation between the United States and a foreign station which is not more than 225 miles from the nearest point in the continental United States, as well as between two such foreign stations, generally is subject to the 5-percent tax where payment for the travel is made in the United States. This tax does not apply to transportation between the United States and other foreign stations where payment is made outside the United States, nor does it apply to the U.S. portions of certain uninterrupted international air transportation (where the

layover does not exceed 6 hours). Also, the air passenger ticket tax does not apply to the portion of flights to or from or between Alaska and Hawaii which are not made over the United States (Code sec. 4262).

[2] The tax did not apply to aircraft owned by a tax-exempt museum operated exclusively for the procurement, care, and exhibition of World War II aircraft (defined in sec. 4041(h)).

[3] The 7 cents a gallon tax on jet fuel expired on October 1, 1980; the 4 cents a gallon tax presently applies only to noncommercial aviation gasoline.

[4] An annual tax of two parts: (1) a $25 annual tax per plane, plus (2) a weight tax of 3½ cents per pound for turbine-power (jet) aircraft and 2 cents per pound for nonturbine-powered aircraft for each pound in excess of 2,500 pounds of "maximum certificated takeoff weight." However, for the period July 1, 1980–September 30, 1980, the use tax was one-fourth the applicable annual rates.

[5] Reduced for nonhighway tires from 5 cents per pound on January 1, 1981.

Trust fund expenditures

Congress has approved expenditures from the trust fund through the fiscal year 1982. (The fiscal 1982 appropriation act for the Department of Transportation, P.L. 97-102, appropriated $1,628 million out of the trust fund.)

In fiscal year 1980 the trust fund paid for about 40 percent of total Federal spending on the airport and airway system.

Administration Proposal

Trust fund taxes

The Administration's proposal would reestablish the Airport and Airway Trust Fund taxes on July 1, 1982, and would finance the Trust Fund with the following schedule of excise taxes:

ADMINISTRATION'S PROPOSED AVIATION EXCISE TAXES

Tax	Tax rate
Air passenger ticket tax	8 percent.
Air freight waybill tax	5 percent.
International departure tax	$3 per person.
General aviation gasoline tax	12 to 20 cents per gallon.[1]
General aviation jet fuel tax	14 to 22 cents per gallon.[2]
Aircraft tire tax	4.875 cents per pound.
Aircraft inner tubes tax	10 cents per pound.

[1] 12 cents in 1982 and 1983, increasing 2 cents annually to 20 cents in 1987.
[2] 14 cents in 1982 and 1983, increasing 2 cents annually to 22 cents in 1987.

Trust fund expenditures

The Administration has stated that through 1987 the trust fund would finance 85 percent of the Federal Aviation Administration's costs; that is, all costs allocable to air carrier and general aviation.

The 1983 budget reflects the Administration's intent to seek higher budget authority for modernizing the National Airspace System if the proposed excise taxes are enacted. The Administration proposes that the trust fund finance airport grants, as well as costs allocable to users for development, acquisition, operation and maintenance of the airport and airway system.

The Administration has stated that its proposals would result in an uncommitted trust fund balance in the range of $.8 billion to $2.3 billion during fiscal years 1983–1987, compared to the $3.0 billion uncommitted balance at the end of fiscal year 1981.

2. Extension of Highway Trust Fund Taxes

Present Law

Receipts from specified excise taxes are transferred from the general fund of the Treasury to the Highway Trust Fund. These revenues are used for payment of contractual obligations incurred by the States in constructing, repairing and reconditioning Federal-aid highways and for meeting other authorized highway-related goals. Excise taxes designated for the Highway Trust Fund have been imposed on (1) the sale of gasoline, diesel fuel, special motor fuels and lubricating oils, (2) the sale of tires, inner tubes and tread rubber, (3) the sale of heavy trucks, trailers and truck parts, and (4) the use of certain heavy highway motor vehicles.

Current rates of tax are shown in the accompanying table. These rates apply until October 1, 1984. Beginning on October 1, 1984, generally lower rates of tax are scheduled to apply (as shown in the table), and amounts collected will no longer be transferred to the Highway Trust Fund. In addition, authority for expenditures from the Highway Trust Fund is scheduled to terminate at the end of fiscal year 1984.

Several exemptions from these taxes are provided in present law, generally relating to off-highway use of gasoline and other motor fuels. There is also an exemption for gasoline sold in a mixture with alcohol (described above in the discussion of business energy tax incentives).

The Surface Transportation Assistance Act of 1978 directed the Secretary of Transportation to make recommendations to Congress by January 15, 1982, concerning any alternative tax structures which may more nearly achieve an equitable distribution of the tax burden among classes of persons and vehicles using Federal-aid highways. (This report has not yet been submitted to the Congress.) This 1978 Act also directed the Secretary of the Treasury to make recommendations to Congress by April 15, 1982, concerning (a) administrative improvements in excise taxation or (b) a new system of raising revenues to fund the Highway Trust Fund which would enhance tax administration, equity and compliance.

CURRENT HIGHWAY USER EXCISE TAXES AND SCHEDULED RATES OF TAX UNDER PRESENT LAW

Tax	Rate of tax, present law	
	Before Oct. 1, 1984	After Sept. 30, 1984
a. Petroleum products:		
1. Gasoline	4 cents per gallon	1.5 cents per gallon.
2. Diesel fuel	4 cents per gallon	1.5 cents per gallon.
3. Special motor fuel	4 cents per gallon	1.5 cents per gallon.
4. Lubricating oil	6 cents per gallon	6 cents per gallon.
b. Tires, tubes and tread rubber:		
1. Tires for highway vehicles	9.75 cents per pound	4.875 cents per pound.
2. Laminated tires	1 cent per pound	1 cent per pound.
3. Other tires	4.875 cents per pound.	4.875 cents per pound.
4. Inner tubes	10 cents per pound	9 cents per pound.
5. Tread rubber	5 cents per pound	No tax.
c. Trucks and truck parts:		
1. Trucks and trailers	10 percent of manufacturer's sale price.	5 percent of manufacturer's sale price.
2. Parts and accessories	8 percent of manufacturer's sale price.	5 percent of manufacturer's sale price.
d. Use tax on heavy vehicles	$3 per 1,000 pounds per year, if more than 26,000 pounds.	No tax.

Administration Proposal

Under the Administration proposal, the present rates of tax for highway user excise taxes would be extended beyond October 1, 1984, and amounts collected would be transferred to the Highway Trust Fund beyond fiscal year 1984. Specific tax legislation is currently under review within the Administration.

In addition, the proposal would terminate as of January 1, 1983, the excise tax exemption for gasoline sold in a gasohol mixture or used in producing such a mixture.

3. Federalism Trust Fund and Federal Excise Taxes

Present Law

Aid to State and local governments for specific purposes

Most Federal funds distributed to State and local governments are appropriated from the general funds of the Treasury, are made available for specific purposes, and often are distributed in accordance with a formula applicable to all States or appropriate local jurisdictions, or are distributed for projects that meet certain criteria for eligibility. In addition, some Federal funds are distributed to State and local governments from trust funds that were established to carry out specific functions, such as the Highway Trust Fund for various highway transportation purposes and the Airport and Airway Trust Fund for the Federal airport and airway system. Such trust funds usually are financed with earmarked tax revenues.

For example, the Highway Trust Fund, discussed above, is composed of designated Federal excise tax revenues that are appropriated to the trust fund for spending on the Federal-aid highway system. The basic purpose of the trust fund is construction of the Interstate Highway System and additions to other Federal-aid highway systems. Funds are allocated among the States according to a formula specified in the law. Funds are made available to liquidate contractual obligations arising from construction of authorized segments of the Federal-aid highway system. Design and construction of the highways must conform with Federal criteria.

General revenue sharing

The General Revenue Sharing Trust Fund was established in 1972 to provide funds that State and local governments would allocate among several general government activities as the governmental units believe meets their needs. Funds are appropriated from Federal individual income tax receipts annually in amounts specified by statute, and distributed among eligible governmental units according to a formula that takes into account the population, income per capita and tax effort. They are allocated to States based on formulations which take into account tax effort, total population, urbanized population, per capita income and tax effort. Prior to fiscal year 1981, State governments received one-third of the allocation and local units of government two-thirds. Beginnning in fiscal year 1981 funds go only to local units of government. They are allocated on the basis of a formula which uses population, per capita income and tax effort.

Local governments may use general revenue sharing funds for any purpose that they may legally spend funds derived through their own local revenue-raising activities.

Total Federal assistance to State and local governments

From fiscal years 1975 through 1981, outlays for Federal grants-in-aid and general revenue sharing to State and local goverments rose from $49.8 billion to $94.8 billion. As a percentage of total budget outlays, these grants varied between 14.4 percent in fiscal year 1981 and 17.4 percent in 1978. For fiscal year 1982, oulays for these grants are estimated at $91.2 billion, and $81.4 billion in fiscal year 1983. In these two years, the grants are estimated at 12.6 and 10.7 percent of total budget outlays.

Administration Proposal

Federalism Trust Fund

The Administration would earmark $28 billion in excise tax revenues to a new Federalism Trust Fund, starting in fiscal year 1984. All revenues from the current alcohol, tobacco and telephone excise taxes would be deposited in the trust fund, plus 2 cents of the 4-cents-per-gallon tax on gasoline and other motor fuels (assuming extension of the 4 cents tax rate beyond September 30, 1984), and a portion of the crude oil windfall profit tax receipts to assure $28 billion annually.

After fiscal year 1987, the Federal excise taxes deposited in the Federalism Trust Fund would start to phase out, by 25 percent each year, and disappear after 1991. The trust fund also would go out of existence after 1991. During the four-year phaseout of the trust fund, the States would be able to impose the same excise taxes or any other taxes they would choose to maintain the same level of revenues from their own sources as they had been receiving from the trust fund.

During a transition period of fiscal years 1984–1987, the States could use their trust fund money in either of the following two ways: (1) Each State could continue to receive some or all Federal grants designated for turnback and use the trust fund money to reimburse the Federal agencies that make those grants, while abiding by Federal conditions and rules, or (2) each State could forego the Federal grant programs and receive its share of trust fund revenues directly for use as it would consider to be appropriate, in which case there would be a mandatory passthrough of part of these funds to local governments.

Turnback of expenditure functions

In exchange for the proposed turnback of Federal revenue sources, initially through the Federalism Trust Fund, the turnback of spending responsibility to State and local governments would cover 44 programs in 6 functional categories.

The turnback programs, by functional categories, would be the following:

(1) *Education and training (5 programs).*—Vocational rehabilitation; vocational and adult education; State block grants; CETA, and WIN.

(2) *Income assistance.*—Low-income home energy assistance.

(3) *Social, health and nutrition services (18 programs).*—Child nutrition; child welfare; adoption assistance; foster care; runaway

youth; child abuse; social services block grant; legal services; community services block grant; prevention block grant; alcohol, drug abuse and mental health block grant; primary care block grant; primary care research and development; black lung clinics; migrant health clinics; family planning, and women, infants and children (WIC).

(4) *Transportation (12 programs).*—Grants-in-aid for airports; highways: primary, rural, urban, bridge, construction safety, highway safety, other; interstate transfer; Appalachian highways; urban mass transit capital and operating programs.

(5) *Community development and facilities (6 programs).*—Water and sewer grants and loans; community facility loans; community development block grants; urban development action grants, and waste water treatment grants.

(6) *Revenue sharing and technical assistance (2 programs).*—OSHA grants, and general revenue sharing.

Federal program responsibility

In addition, the Federal Government would assume full responsibility for the Medicaid program, and the States would be expected to assume full responsibility for the Food Stamp program, presently federally-financed and State-administered, and Aid to Families with Dependent Children (AFDC), now financed jointly by Federal and State Governments.

Excise taxes earmarked for proposed Federalism Trust Fund

The proposed trust fund would be financed initially with the receipts from present law excise taxes on alcohol, tobacco, telephones, one-half of the gasoline tax, and a portion of the crude oil windfall profits tax.

A summary of these excise taxes follows.

Alcohol taxes:	
Distilled spirits	$10.50 per proof gallon.
Beer	$9.00 per barrel generally.[1]
Still wines:	
Up to 14 percent alcohol	17 cents per wine gallon.
14 to 21 percent alcohol	67 cents per wine gallon.
21 to 24 percent alcohol	$2.25 per wine gallon.
Champagne and sparkling wines.	$3.40 per wine gallon.
Artifically carbonated wines	$2.40 per wine gallon.
Alcohol occupational taxes:	
Brewers	$110 a year; $55 for less than 500 barrels a year.
Still manufacturers	$55 a year plus $22 per still.
Wholesale dealers:	
Liquors and wines	$255 a year.
Beer	$123 a year.
Retail dealers:	
Liquors and wines	$54 a year.
Beer	$24 a year.
Tobacco taxes:	
Small cigars	75 cents per thousand.

Large cigars	8½ percent of wholesale price, up to $20 per thousand.
Small cigarettes	$4 per thousand.
Large cigarettes	$8.40 per thousand.
Cigarette papers	½ cent per 50 papers.
Cigarette tubes	1 cent per 50 tubes.
Telephone taxes:	
Local and toll telephone service and teletypewriter service.	1 percent, 1982–84.
Gasoline and other motor fuels taxes:	
Through September 30, 1984	4 cents per gallon.
On and after October 1, 1984	1½ cents per gallon.
Crude oil windfall profit tax:	
Tier 1 (old oil)	70 percent; 50 percent for independent producers through 1982; no tax thereafter.
Tier 2 (stripper or from national petroleum reserve).	60 percent; 30 percent for independent producers.
Tier 3 (new oil)	30 percent in 1982, 27½ percent in 1983, 22½ percent in 1984, 20 percent in 1985, and 15 percent in 1986 and thereafter.
	30 percent on heavy and tertiary oil.

[1] $7 per barrel for certain small brewers.

The entire windfall profit tax will phase out over a 33-month period after December 31, 1987, or when cumulative net revenues raised by the tax reach $277.3 billion, whichever is later. The phaseout will begin no later than 1991.

Generally, collections from the excise taxes proposed for the Federalism Trust Fund, except for the windfall profit tax, indicate a pattern of falling receipts. From $14 billion in fiscal 1979 and $16.5 billion in fiscal 1980, the estimated excise tax revenues decline to a range of $13.1 billion to $13.5 billion in fiscal years 1981–1983. The estimates for fiscal years 1982 and 1983 are shown in the following table, compared with actual collections for fiscal years 1979, 1980, and 1981.

COLLECTIONS FROM EXCISE TAXES PROPOSED FOR FEDERALISM TRUST FUND IN FISCAL YEARS 1979–1983

[Millions of dollars]

	Fiscal years				
	Actual			Estimated	
	1979	1980	1981	1982	1983
Alcohol taxes:					
Distilled spirits ..	3,909	3,919	3,819	4,182	4,080
Wine.....	198	211	244	243	245
Beer.....	1,502	1,545	1,604	1,672	1,644
Refunds	−117	−104	−82	−84	−87
Total alcohol taxes.....	5,492	5,571	5,585	6,013	5,882
Tobacco taxes:					
Cigarettes.....	2,455	2,403	2,539	2,694	2,622
Cigars.....	36	40	41	40	40
Imports, papers and tubes.....	4	4	4	4	4
Refunds	−3	−4	−3	−3	−3
Total tobacco taxes.....	2,492	2,443	2,581	2,735	2,663
Gasoline tax [1]	4,368	3,900	3,889	3,858	3,810
Diesel and special fuels [1]	497	523	561	575	613
Telephone and teletypewriter services.....	1,362	1,118	999	796	656
Windfall profit tax [1]		5,959	[2] 23,273	24,116	21,245
Grand Total	14,211	19,514	36,888	38,093	34,869

[1] Net of refunds.
[2] Fiscal year 1983 Budget figure.

Source: Annual Reports of Commissioner of the Internal Revenue Service for fiscal years 1979-80; Budget for fiscal year 1983 for fiscal years 1981, 1982 and 1983.

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D. Employment Taxes

1. Extension of Social Security Hospital Insurance Taxes to Federal Employees

Present Law

The Federal Insurance Contributions Act (FICA) imposes two employment taxes on employers and employees: a "social security" tax and a "hospital insurance" tax. The two FICA taxes are imposed on wages paid for employment, and both taxes are imposed at rates which are the same for both employer and employee.[1] The amount of wages taxable for a calendar year is subject to a limit ($32,400 for 1982) which is adjusted each year according to the increase in average wage levels.

Revenues from the social security FICA tax are deposited into the Old-Age and Survivors Insurance and the Disability Insurance Trust Funds and finance the payment of old-age, survivors, and disability insurance benefits payable under the Social Security Act. This tax is imposed at the rate of 5.4 percent of wages received from employment during calendar years 1982–1984, 5.7 percent of wages received during the years 1985–1989, and 6.2 percent of wages received after December 31, 1989.

Revenues from the hospital insurance FICA tax are deposited into the Hospital Insurance Trust Fund and finance the costs of hospital and related post-hospital services (Part A of Medicare) incurred by beneficiaries as provided for in the Social Security Act. This tax is imposed at the rate of 1.3 percent of wages received from employment during the calendar years 1982–1984, 1.35 percent of wages received during 1985, and 1.45 percent of wages received after December 31, 1985.

Eligibility for social security and Medicare benefits is generally determined by the number of quarters during which an individual (and his employer) has paid FICA taxes.

In general, wages from all kinds of employment are subject to FICA taxes. However, certain types of employment or trades or businesses are exempt from social security coverage. Individuals employed by the United States or any instrumentality of the United States, other than members of the uniformed services, are generally excluded from paying FICA taxes if (1) the employment comes under a retirement system established by a law of the United States, (2) the service is performed for certain U.S. instrumentalities that were exempt from tax in 1950, and for which the instrumentality has established a retirement system, or (3) the service is performed by certain specific individuals or groups.

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[1] The Self-Employment Contributions Act imposes two similar taxes on self-employed individuals at rates different from the FICA tax rates.

Administration Proposal

Under the proposal, all Federal employees would be subject to the hospital insurance FICA tax, effective January 1, 1983. Thus, Federal employees who meet the eligibility requirements, and their families, eventually would be entitled to Medicare (Part A) benefits.

2. Revision of Railroad Retirement System

Present Law

The railroad retirement system, which is administered by the Federal Railroad Retirement Board, provides benefits that are generally equivalent to a combination of social security, unemployment insurance, and a multi-employer industry pension plan. Railroad employees and employers pay taxes to the railroad retirement system that are generally equivalent to social security taxes (Tier 1). Employers also pay a (Tier 2) tax of 11.75 percent of monthly taxable compensation to the industry plan; the employee Tier 2 tax is 2 percent.

Administration Proposal

Under the Administration proposal, railroad employees would be treated like all other private sector employees; that is, they would be provided with social insurance through social security and regular State unemployment insurance programs. Thus, they and their employers would be liable for social security and Federal and State unemployment insurance taxes rather than railroad retirement taxes. The Administration also proposes to return the rail industry's plan to the private sector, so that the Tier 2 taxes would be eliminated.

The proposal would be effective beginning October 1, 1982.

E. User Charges

1. Coast Guard User Fees

Present Law

Currently, no charge is made for most services provided by the Coast Guard for the public, such as issuing licenses, inspecting facilities, certifying vessel construction, maintaining aids to navigation, and providing rescue and assistance service.

Administration Proposal

Under the proposal, the Secretary of Transportation would be granted administrative authority to institute user fees for certain Coast Guard services. Fees for direct services involving a transaction (e.g., licenses and inspections) would be set according to the cost of providing the services. Other services performed by the Coast Guard (e.g., maintaining navigation aids and providing search and rescue services) would be financed by an annual fee or other type of charge.

2. Navigation User Fees

Present Law

Locks, dams and channels are constructed and maintained by the Corps of Engineers and the Tennessee Valley Authority for barge traffic on the inland and intracoastal waterways. The Corps also dredges harbor channels and constructs and maintains other facilities for ocean-going and Great Lakes traffic. Construction and upkeep of both inland and deep draft waterways are financed by a tax on fuels used in a vessel in commercial inland and intracoastal waterway transportation or with funds appropriated from the general fund of the Treasury Department. The fuels tax is deposited in the Inland Waterways Trust Fund from which appropriations are made for these purposes. The fuels tax presently is 6 cents per gallon, and is scheduled to increase to 8 cents on October 1, 1983, and to 10 cents on October 1, 1985.

Administration Proposal

The proposal would grant the Secretaries of the Army and Transportation administrative authority to establish a system of user fees to offset the cost of outlays for construction, maintenance, and various services related to inland and deep-draft waterways. Amounts raised by these user fees would be deposited into the Inland Waterways Trust Fund. They would be recorded in the budget accounts as offsetting receipts to outlays for construction, operation, and maintenance of inland and deep-draft waterways.

The Administration has proposed a reduced funding level for some navigation projects, and additional funding will be requested when adequate reimbursement for navigation project operation and maintenance is available through establishment of user fees.

3. Nuclear Waste Disposal fee

Present Law

User fees are not imposed at present on electric utilities which produce nuclear waste materials as a byproduct of electricity generation. The Department of Energy currently is conducting a program designed to develop and implement nuclear waste disposal technology, and general revenues bear the cost of this program.

Administration Proposal

The Administration legislative program includes support for S. 1662. This bill would require the Secretary of Commerce to impose a fee, now estimated at one mill per kilowatt hour, on electricity generated by civilian nuclear power plants. The proceeds of this fee, estimated by the Administration to be $300 million in 1983 and $657 million in 1987, would be used to establish a self-sustaining fund for developing alternative nuclear waste disposal technologies and operating nuclear waste repositories.

4. Energy Regulatory Fees

Present Law

The Federal Energy Regulatory Commission (FERC) issues permits and licenses and sets rates for producer sales of natural gas, operation of oil and natural gas pipelines, development of hydroelectric power, and interstate wholesale sales of electric power. Fees are now charged for certain of the commission's services and for certain pipeline and hydropower activities.

Administration Proposal

The Administration will propose legislation that would authorize FERC to set user fee schedules for licensing and other FERC activities and to retain the receipts so that the agency would become self-supporting. FERC would establish new fees applicable to companies making license and other applications. Fee schedules would be expanded to include services such as electric and natural gas rate determinations not now subject to fees. For services such as pipeline approvals and hydropower licenses, existing fees would be increased substantially. The Administration estimates that these proposed changes would raise $35 million in 1983 and would cover roughly two-thirds of the cost of the FERC's programs.

5. Recreation User Fees

Present Law

Several Federal agencies, e.g., National Park Service, provide outdoor recreational facilities for the public. However, present law

restricts the number of facilities for which entrance or admissions fees may be charged. In addition, the fees actually imposed (generally $3 per visit or $10 for an annual Golden Eagle passport) do not cover all the costs of providing such facilities.

Administration Proposal

The Administration will submit a proposal to increase existing entrance and user fees and expand the number of facilities for which fees may be charged. Under the proposal, authority will be sought to adjust fees for inflation and set comparable fees for comparable areas and facilities. The Administration intends that the receipts from these fees will be used in the budget accounts to offset outlays for recreational resources.

6. Patent and Trademark Fees

Present Law

Applications for patent protection and trademark registration are processed by the Patent and Trademark Office (PTO). Although PTO is authorized to impose application and issuance fees, those fees do not cover all the actual processing costs incurred.

Administration Proposal

The Administration will submit a proposal to increase the patent and trademark application and issuance costs to cover actual processing costs. With respect to patents, 50 percent of the costs would be payable prior to the issuance of the patent, and the remainder would be recovered over the life of the patent.

7. Passport and Visa Fees

Present Law

Passport fees are generally limited to $15, and immigrant visa fees are generally limited to $25.

Administration Proposal

The Administration has proposed to increase passport fees to $30, effective April 1, 1982, and to increase immigrant visa fees to $100, effective March 1, 1982. The increase in passport fees requires legislation, but visa fees may be increased under existing administrative authority.

8. Other User Fees

Present Law

Some Federal Government programs and activities provide services that benefit identifiable specific industries or economic groups. User fees have been charged only for some of these programs. Where fees have been charged, the rates have not been changed since instituted or were revised last in the late 1960's or early 1970's.

Administration Proposal

The Administration intends to submit proposals to increase or institute additional user fees, beginning in 1983 that would:

(1) gradually increase charges for maps and charts issued by the National Oceanic and Atmospheric Administration (NOAA) to achieve full cost recovery by 1986;

(2) authorize the Federal Mediation and Conciliation Service (FMCS) and the National Mediation Board (NMB) to impose fees equal to the total costs of services provided;

(3) impose a 0.5 percent funding fee on residential housing loans guaranteed pursuant to the Veterans Administration's Loan Guarantee Program;

(4) initiate transaction fees and licenses to cover the full cost of the regulatory operations of the Commodity Futures Trading Commission; and

(5) increase the commitment authority application fees and annual guarantee fees currently charged to securities issuers by the Government National Mortgage Association (GNMA) and to impose an additional fee on new GNMA securities issuers.

III. ADMINISTRATION'S ESTIMATES OF BUDGET EFFECTS OF PROPOSALS

[Fiscal years, in billions of dollars]

	1982	1983	1984	1985	1986	1987
A. Income tax provisions:						
1. Completed contract method of accounting	(1)	2.0	4.5	4.6	4.1	3.9
2. Repeal of business energy tax credits		0.1	0.3	0.5	0.5	0.5
3. Limitation on tax-exempt revenue bonds		−0.2	0.3	1.1	2.1	3.2
4. Modified coinsurance	0.9	1.9	2.2	2.5	2.7	3.0
5. Construction period interest and taxes		0.5	1.0	1.0	1.0	0.9
6. Corporate minimum tax		2.3	4.8	4.5	3.7	3.8
7. Enterprise zones			−0.1	−0.5	−0.9	−1.3
Total, income tax provisions	**0.9**	**6.7**	**12.9**	**13.7**	**13.2**	**14.0**
B. Tax collection and enforcement provisions:						
1. Withholding on interest and dividends		2.0	1.3	1.4	1.6	1.9
2. Acceleration of corporate income tax payments		1.4	1.7	0.9	0.2	−0.2
3. IRS staff increases [2]	0.2	2.1	2.4	2.4	1.3	0.6
4. Debt collection proposals [3]	1.3	2.4	2.4	2.8	2.8	2.8
Total, tax collection and enforcement provisions	**1.5**	**7.8**	**7.9**	**7.5**	**5.8**	**5.1**
C. Excise taxes:						
1. Airport/airway trust fund taxes	0.1	1.2	1.4	1.5	1.7	1.9

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III. ADMINISTRATION'S ESTIMATES OF BUDGET EFFECTS OF PROPOSALS—Continued

[Fiscal years, in billions of dollars]

	1982	1983	1984	1985	1986	1987
2. Extension of highway trust fund taxes				4.2	4.4	4.5
3. New Federalism trust fund (transfer of certain excises)						
Total, excise taxes	**0.1**	**1.2**	**1.4**	**5.7**	**6.1**	**6.5**
D. Employment taxes:						
1. Extension of social security hospital insurance taxes to Federal employees		0.6	0.8	0.9	1.1	1.2
2. Revised railroad retirement fund [4]		−1.7	−1.8	−1.9	−2.0	−2.1
Total, employment taxes		**−1.1**	**−1.0**	**−1.0**	**−1.0**	**−1.0**
E. User charges: [4]						
1. Coast Guard user fees		0.2	0.8	0.8	0.8	0.8
2. Navigation user fees		0.4	0.5	0.5	0.5	0.5
3. Nuclear waste disposal fees		0.3	0.5	0.5	0.6	0.7
4. Energy regulatory fees		(1)	(1)	(1)	(1)	(1)
5. Recreation fees		0.1	0.1	0.1	0.1	0.1
6. Patent and trademark fees		(1)	(1)	(1)	0.1	0.1
7. Passport and visa fees	(1)	0.1	0.1	0.1	0.1	0.1
8. Other user fees		0.1	0.2	0.2	0.2	0.2
Total, user charges	**(1)**	**1.3**	**2.1**	**2.2**	**2.3**	**2.4**
Grand Total, All Provisions	**2.5**	**15.9**	**23.3**	**28.1**	**26.5**	**27.0**

[1] Gain of less than $50 million.

[2] The figures shown as line items represent only increases in revenue. In addition, outlays would be increased by $0.2 billion annually.

[3] Other than IRS staff increases.

[4] The figures shown as line items represent only reductions in revenue. In addition, outlays would be reduced by $2.0 billion in fiscal year 1983, $2.2 billion in 1984, $2.4 billion in 1985, $2.5 billion in 1986, and $2.7 billion in 1987.

[5] Most of these items are shown in the budget as offsetting receipts. The exceptions are passport and visa fees.

Note: Details may not add to totals because of rounding.

Source: U.S. Treasury Department and Office of Management and Budget.